No. 16-1454

IN THE

Supreme Court of the United States

STATE OF OHIO, *et al.*,
Petitioners,

v.

AMERICAN EXPRESS COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE INTERNATIONAL AIR TRANSPORT ASSOCIATION AND AIRLINES FOR AMERICA AS *AMICI CURIAE* IN SUPPORT OF THE PETITIONERS

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QUESTIONS PRESENTED

Whether, under the Sherman Act rule of reason, the Governments' showing that American Express's "anti-steering" provisions stifled network price competition on the merchant side of the credit-card platform suffices to prove anticompetitive effects and thereby shift to American Express the burden of establishing any procompetitive benefits from the provisions.

Whether the operator of a two-sided platform can justify under the Sherman Act its monopolistic exploitation or anticompetitive restraints in the market on the first side, because this profit-enhancing conduct can generate ongoing subsidies which the platform then uses to attract and retain users in the separate market on the second side.

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INTEREST OF *AMICI*[1]

The International Air Transport Association ("IATA") is a nongovernmental international trade association founded in 1945 by air carriers engaged in international air services. Today, IATA consists of 282 member airlines from 123 countries representing roughly 84 percent of the world's total air traffic. IATA strives to represent, lead, and serve the airline industry by advocating the interests of airlines across the globe, developing global commercial standards for the airline industry, and assisting airlines in operating safely, securely, efficiently, and economically. Since 1945, IATA has worked closely with governments and intergovernmental organizations to achieve and maintain a legal and regulatory framework everywhere consistent with the best interests of air transportation users.

Airlines for America ("A4A") is the nation's oldest and largest airline trade association, representing the leading passenger and cargo airlines of the United States. Its passenger carrier members and their marketing partners accounted for 72 percent of all U.S. scheduled passenger airline capacity and carried 593 million passengers in 2016. A4A advocates on behalf of its members to shape crucial policies and measures that promote a safe, secure, and healthy U.S. airline industry. It works collaboratively with airlines, labor, government agencies, Congress, and other groups to improve air travel for everyone. Since

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[1] No party's counsel authored this brief in whole or in part and no person or entity other than *amici* or their counsel made a monetary contribution to the preparation or submission of this brief. All counsel of record consented to the filing of this brief.

its inception, A4A has played a major role in significant government decisions regarding the aviation industry and it regularly participates in litigation that impacts commercial air transportation.

Credit card fees for passenger ticket sales represent a major cost for IATA and A4A members, and therefore IATA and A4A have been actively concerned on an ongoing basis about credit card fee levels and anticompetitive rules and practices employed by the major credit card networks.

IATA, A4A, and their members are anxious that the U.S. antitrust laws be enforced against the American Express ("Amex") "anti-steering" rule, which the District Court found to have reduced competition among card systems on the merchant side of the platform, and hence resulted in higher credit card fees being paid by airlines and other card-accepting merchants.

IATA and A4A members have a strong interest in this Court rejecting the kinds of justifications accepted by the Second Circuit for what should be clear Sherman Act violations in the distinct and separate market for merchant participation, irrespective of the fact that they were advanced in relation to a two-sided platform.

SUMMARY OF ARGUMENT

In the last 25 years, the Internet has led to the increasing prevalence and greatly enhanced economic importance of two-sided platforms. Credit card networks (e.g., Visa, MasterCard, and American Express) are prominent pre-Internet two-sided platforms that connect card-paying consumers with card-accepting merchants.

Each side of such two-sided platforms normally represents a separate and distinct market, with different competitive conditions on each side. Credit card networks are no exception. A network such as American Express or Visa enjoys substantial market power vis-à-vis merchants because a competitive merchant does not want to lose valuable transactions because it will not accept the consumer's preferred (or only) card. Each network has responded to this reality by charging merchants high "interchange" fees which are then largely used to incentivize the card-issuing institutions to issue the particular network's cards. The net result is that, on the card-issuing side of the platform, credit card networks vie to get card-issuers to actively recruit new cardholders and to encourage existing cardholders to use the issuer's card more often.

This whole picture was clearly documented by the District Court after a seven-week trial in which the court found that the American Express anti-steering rule reduced competition among the networks in the "merchant servicing" market and thus resulted in higher credit card servicing fees to merchants.

The Second Circuit, ignoring these detailed findings, held that a trial court had to (1) combine the two sides of the platform (involving different participants and non-interchangeable transactions) into a single aggregated market and then (2) use the rule of reason to balance merchant losses against the value of the "rewards" that card-issuers gave to consumers to encourage use of their cards (which are largely funded by the merchant fees that are the source of the merchant losses).

The Court of Appeals' "apples and oranges" approach to market definition is entirely inconsistent

with the well-developed antitrust approach to assessing anticompetitive conduct, and it makes no economic sense. It is also inconsistent with established legal precedents, including those relating to the two-sided newspaper industry, which is characterized by advertising sales on one side of the platform and newspaper subscriptions on the other—both are distinct and separate relevant antitrust markets. *See Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 610 (1953).

It is important that the Court correct the Second Circuit's novel and erroneous approach, and make clear that anticompetitive restraints normally have to be analyzed separately on each side of a two-sided platform.

ARGUMENT

I. THIS CASE GIVES THE COURT A TIMELY OPPORTUNITY TO CLARIFY THE ANTITRUST RULES FOR TWO-SIDED PLATFORMS WHICH HAVE BECOME INCREASINGLY IMPORTANT IN TODAY'S INTERNET-BASED SERVICES ECONOMY.

The Internet has caused multi-sided platforms to proliferate. Some of the more familiar platforms connect buyers with sellers (e.g., OpenTable), while other platforms connect advertisers with consumers of advertising content (e.g., Google and Facebook). However, while consumers are familiar with how they interact with the side of a platform facing them, they generally are less familiar or even unfamiliar with the competitive dynamics on the other side of the platform.

The two-sided credit card platform and the fees paid by airlines as merchants have a major impact on the airline industry, but it is only one of a number of such two-sided platforms that significantly impact airlines. Travel ticket distribution intermediaries (known as Global Distribution Systems or GDSs), like Sabre, Travelport, and Amadeus, connect travel agents with travel suppliers, including members of IATA and A4A.[2] And airlines, like most major businesses, advertise on social media and other Internet publishers, participating in two-sided platforms that involve consumers of information on one side of the platform and advertisers on the other.

These two-sided platforms are often unique in the manner in which the people and entities participating in the separate market on each side of the platform are affected by competition. For instance, Uber is a two-sided platform, matching drivers on one side of the platform with passengers on the other. It competes with other ride-share companies, like Lyft, taxi companies, and town car companies for both drivers and riders. However, the platform is also entirely

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[2] However, in a recently concluded trial in the Southern District of New York, a federal jury properly characterized the GDS market as one-sided from an economic standpoint, and therefore correctly analyzed the effect of GDS anti-steering rules only on travel suppliers, without regard to benefits GDSs may provide to travel agents that supplier payments fund. Sabre has filed a currently pending appeal to the Second Circuit, arguing, based on the Court of Appeals' opinion in this case, that *all* two-sided electronic platforms need to have their economic effects analyzed by looking at whether the restraints at issue on the merchant side of the platform are offset by benefits to users on the other side. *See U.S. Airways, Inc. v. Sabre Holdings Corp., et al.*, Case No. 17-960 (2d Cir. 2017).

distinct from the two-sided credit card platforms. Unlike merchants, drivers do not set their own prices from which a fee is then taken; instead, drivers receive a percentage of the fare set by Uber without the drivers' input. *See O'Connor v. Uber Techs.*, 82 F. Supp. 3d 1133, 1142 (N.D. Cal. 2015). And, of course, lower barriers to entry, that passengers can bicycle or drive their own cars, and that drivers can get other jobs (as drivers or doing other work) keep the markets for both drivers and passengers competitive.

However, in both the case of Uber and the case of credit cards, treating the two-sided platform as a single market rather than two distinct markets would lead to absurd results. Would Uber be free to engage in anticompetitive restraints in the market for drivers as long as both Uber and Uber passengers benefited in some manner? Could it do so even if Uber's conduct increased the prices paid by all passengers, whether in taxis, Ubers, or Lyfts?

The Court of Appeals' decision raises a multitude of similar questions. It even leaves open the question of whether competitors could be permitted to divide markets or engage in other activities that would normally be *per se* illegal under Section 1 of the Sherman Act, so long as some consumers benefit even if others are harmed. *See Cal. ex rel. Harris*, 651 F.3d 1118, 1137 (9th Cir. 2011) ("where, as here, the conduct at issue is not a garden-variety horizontal division of a market, we have eschewed a *per se* rule and instead have utilized rule of reason analysis" (internal quotation marks omitted)). Such a rule would undermine the central policy of antitrust law: protecting consumers from restraints of trade. In this case, Amex's anti-steering rules cause most consumers to suffer net harm by higher prices because

competition was restrained on one side of the platform, while a subset of cardholders with high-reward cards may be better off. Antitrust law should not allow this result.

The Court of Appeals' decision would render those on the merchant side of a two-sided platform vulnerable to anticompetitive behavior because economic necessity forces those merchants to participate in a dominant platform to be able to access the largest number of customers, even when the platform is an exploitative monopoly. *See* Pet. App. 162a-163a. The proliferation of major two-sided platforms in the Internet age makes this an appropriate time for the Court to articulate clear rules for two-sided platforms that are manageable for district courts to administer and that protect competition on both sides of these platforms; each side must be considered its own separate and relevant antitrust market.

II. THE SECOND CIRCUIT'S MARKET-CONFLATING ANALYSIS IGNORED CREDIT CARD MARKET REALITIES IN THE DISTRICT COURT'S FINDINGS.

A. Competition and Market Power in Credit Card Markets

Credit card networks are based on an unusual economic reality—the person who makes the critical choices (the consumer) does not pay the fees associated with her choices. And thus we have gradually evolved a credit card system in which consumers are encouraged to make the least efficient (i.e., most expensive) choices from the standpoint of the merchants who have to pay for the consumer's choice. The credit card networks' anti-steering rules were

designed to reinforce consumers' likelihood of making inefficient choices by keeping them in the dark regarding those inefficiencies.

In a credit card network, the issuers of cards dominate a market in which merchants must participate if they do not want to lose sales by failing to accept potential customers' card of choice. As a result, merchants have to "multi-home" on the major credit card platforms. Responding to this reality, the major credit card systems (Visa, MasterCard, and American Express) have set up competing network systems with substantial interchange fees which are charged to merchants. These fees then flow back to the issuer of the card that the consumer used for the transaction. The routing of the transaction controls which network's interchange fee is charged, and routing is based on which card the consumer has chosen to give to the merchant at the point of sale.

In order to encourage consumers to sign up for and use its card(s), a card issuer will use some of its interchange fee revenues to provide rewards (e.g., free travel using airline miles purchased from an airline) or special discounts on transactions using the card. Generally, the higher the rewards are for use of a particular card, the higher the network interchange fee charged to the merchant for a transaction using the card.

Amex's business strategy is fundamentally based on this reality—so its merchant fees are higher than any other system, and its rewards program is among the most generous in the industry. Its card business is quite profitable because the total merchant fees that it collects are more than twice its total costs of providing cardholder rewards or discounts. Even the Court of Appeals recognized, and "Amex conceded," that "not

all of Amex's gains from increased merchant fees are passed along to cardholders in the form of rewards." Pet. App. 51a. In fact, as the United States pointed out in its brief, "Amex spends less than half of its merchant fees on cardholder rewards." Brief of the United States as Respondent Supporting Petitioners at 48 (citing Pet. App. 210a-211a; Tr. 3853).

Airlines (and presumably other merchants, too) build average credit card transaction costs into their prices—impacting all passengers whether or not they use a credit card.

In the end, card-issuers have substantial market power vis-à-vis the merchant as reflected by the anticompetitive behavior exhibited by the credit card networks towards merchants. The result is that credit card networks offer a classic example of dramatic competitive imbalance between the markets on each side of a two-sided platform—with monopolistic power on one side of the platform maintained by the enforcement of anti-steering rules.

In a more competitive market for these network services, merchants would be in a position to play one service against another to achieve lower merchant fees. A merchant could then charge consumers using credit cards more for transactions that cost the merchant more in credit card fees, thus tending to reduce system-wide costs. This is what the Amex anti-steering rule is designed to prevent at the point of sale—i.e., to prevent the consumer from choosing a lower-fee card based on information or incentives provided by the merchant. In the current system, these fees flow through to the card issuer, which uses some of this profit center to offer rewards that lure uninformed consumers to sign up for and then use their cards.

This is the competitive reality that was ignored by the Court of Appeals after it had been so carefully described by the District Court.

B. The District Court's Findings

The United States District Court for the Eastern District of New York conducted a seven-week bench trial after which it made detailed factual findings based upon a voluminous evidentiary record. Pet. App. 72a-73a. These factual findings are undisturbed by the Second Circuit, and yet undermine its basis for reversal.

The District Court concluded as a factual matter, based on ample evidence, that the relevant product market for evaluating the anti-steering rule is the market for card network services. "Competition in the GPCC [General Purpose Credit and Charge] card industry occurs on at least two distinct yet interrelated levels: (1) at the card issuance level, where American Express and Discover compete against each other and against the thousands of Visa- and MasterCard-issuing banks; and (2) at the network services level, where Visa, MasterCard, American Express, and Discover compete." Pet. App. 117a-118a.

The court also found as a factual matter that:

> American Express does possess antitrust market power in the GPCC card network services market sufficient to cause an adverse effect on competition. Specifically, the court finds that Defendants enjoy significant market share in a highly concentrated market with high barriers to entry, and are able to exercise uncommon leverage over their merchant-consumers due to the amplifying effect of cardholder insistence and derived demand. In addition, American Express's

> ability to impose significant price increases during its Value Recapture initiatives between 2005 and 2010 without any meaningful merchant attrition is compelling evidence of Defendants' power in the network service market.

Pet. App. 150a.

The court specifically found as to Amex that "the degree to which its cardholders insist on using their Amex cards affords the network significant power over merchants, particularly in a market in which merchants' primary recourse when faced with a price increase or similar conduct is an 'all-or-nothing' acceptance decision." Pet. App. 159a-160a (citing testimony of Plaintiffs' economics expert). The District Court also found ample evidence to support its conclusion that competition for card users, via such benefits as reward programs, operated in a way that was integrally related to, *but distinct from*, competition among card systems for merchant contracts. Pet. App. 116a-122a.

Ultimately, the District Court found, again on evidence that is undisturbed by the Second Circuit, that the anti-steering rules "allowed all four networks to raise their [merchant] fees more easily and more profitably than would have been possible were merchants permitted to influence their customers' payment decisions." Pet. App. 207a. Thus, these rules harmed both merchants and consumers: "the court finds that the challenged restraints have impaired the competitive process in the network services market, rendering low-price business models untenable, stunting innovation, and resulting in higher prices for merchants and their consumers." Pet. App. 192a.

The Court of Appeals fundamentally objected, accusing the District Court of having "defined [the network services market] in a conclusory manner." Pet. App. 37a. The appellate court reasoned that the trial court should have applied the "hypothetical monopolist test" to determine whether Amex could profitably increase merchant fees without losing profits from the consumer side of the two-sided platform. Pet. App. 38a-40a.

That was clear error on the part of the Second Circuit. The trial court specifically found, again on voluminous evidence, that Amex *actually did profitably impose higher merchant fees, unconstrained by competition*:

> By precluding merchants from directing transactions to other networks, Amex's merchant restraints blocked an important safety valve that would have moderated its efforts to increase discount rates. (*See* Tr. At 3846:1-15, 3850:8-17 (Katz).) Among large merchants, for example, American Express did not even account for the possibility that merchants would respond to its price increases by attempting to shift share to a competitor's network when assessing the likely profitability of Value Recapture, and instead considered only whether merchants would cease acceptance altogether as a result of the initiative. (*See id.* at 3849:10-3850:17 (Katz); PX1099 at '555.)

Pet. App. 208a. Amex determined that steering by smaller merchants would not have a sufficient impact to make raising its discount fees unprofitable. *See id.*

The Court of Appeals also ignored the clear adverse effect on consumers that was detailed in the District Court's opinion:

> The [anti-steering rules] have also resulted in increased prices for consumers. Merchants facing increased credit card acceptance costs will pass most, if not all, of their additional costs along to their customers in the form of higher retail prices. (*See* Tr. At 3840:10-23, 3854:18-3855:25 (Katz) (testifying that 'an economically rational merchant is going to pass [the higher costs of accepting payments] on to its customers,' and 'prices are going to go up with the merchant for everybody'); *see also id.* at 1405:22-1407:11 (Rein/Walgreen); DX2214 at '983.).

Pet. App. 210a-211a.

This is the basis for IATA and A4A's concern. Airlines, like other merchants, have to account for merchant fees when setting their air fares—so their cash or check-paying passengers, or passengers using cards for which lower merchant fees are imposed, are paying more than they would if credit card fees were lower.

III. THE SECOND CIRCUIT'S ERROR ON THE TWO-SIDED PLATFORM ISSUE NEEDS CORRECTION.

The Second Circuit's decision involved a failure to face a series of realities, which are economic, legal, and practical.

A. Need for an Economically Rational Market Definition

The Second Circuit's conflation of the two-sided, two-market platform into a single relevant antitrust market is unsound as a matter of antitrust policy. To conflate the markets on each side of a two-sided platform into a single relevant antitrust market both unleashes inefficient market conduct and imposes impossible burdens on litigants and courts. If left standing, the Second Circuit's approach would free dominant players on one side of two-sided platforms (Google, Uber, Facebook, etc.) to exploit their monopoly power with apparent impunity. Moreover, faced with antitrust challenges to such conduct, courts would be left with an impossible task of balancing anticompetitive harms to victims on one side of the market against purported benefits to entirely different groups on the other side. The Court of Appeals offered no guidance on how a court (let alone antitrust counsel trying to guide clients along permissible lines) would begin to calculate the net effects.

Of course, the competitive conditions for any given two-sided platform may differ, so the effects of restraints on each such platform merit discrete analysis. However, applying a "benefits balancing" process to credit cards shows the deficiency in the Second Circuit's relevant market analysis. The merchant side of the platform is obviously harmed by higher fees. What benefit does an airline get from paying higher merchant fees to American Express? These fees are in part used by Amex to fund consumer rewards, thus inducing consumers who already have a Visa card to use the very card (Amex) that imposes the highest cost on the airline. Whatever benefit the consumer perceives herself to get from this system is

less than the cost to the merchant, and is also diminished by the higher prices the merchant is likely to charge all customers.

This Court already decided long ago that two-sided platforms form part of two separate and distinct relevant antitrust markets. *Times-Picayune Publishing Co. v. United States* involved a publisher's alleged tying of morning and evening advertisement placements, which this Court declined to condemn in part because there were no separate products thus "tied." In so ruling, the Court acknowledged that "every newspaper is a dual trader in separate though interdependent markets; it sells the paper's news and advertising content to its readers; in effect that readership is in turn sold to the buyers of advertising space. *This case concerns solely one of these markets.*" *Times-Picayune*, 345 U.S. at 610 (emphasis added).

Since then, antitrust law has settled squarely on the definition of relevant markets by cross-elasticity of demand, or substitutability of products. Card payment network services constitute one product; card issuance to consumers is quite another. They are not substitutes for either the consumer or the merchant: an airline negotiating a merchant agreement with Amex does not regard an airline ticket as a substitute for the network services it is seeking; a consumer looking to fly from New York to Cleveland does not regard network services as a substitute for a seat on an airplane. The fact that the two sides are *interdependent* is entirely different from saying that they are *interchangeable*.

B. Need to Respond to Clear Anticompetitive Effects

The essential problem is that the Second Circuit, to use the words of the trial court, takes its two-sided platform analysis "too far." Pet. App. 117a. Its flawed application of the hypothetical monopolist test would allow a monopolist to engage in otherwise illegal conduct victimizing one group so long as its activities somewhere else benefitted some other group in a related market. This view of two-sided platforms departs from precedent.

As the District Court analyzed in detail, the history of the credit card industry demonstrates that Discover attempted to introduce competition in the merchant market through low-price merchant fees two decades ago, but was thwarted by the other networks' anti-steering rules. Pet. App. 203a-206a. There is no sound reason to allow that outcome: as a matter of unarguable economics, higher fees paid by merchants *mean* higher prices to consumers. And since not all, or even most, of these consumers use Amex cards, whatever benefits Amex might bestow on its own cardholders are irrelevant to a clear majority of the consuming public.

Furthermore, the Second Circuit failed to consider how a District Court should analyze a restraint that normally falls under a *per se* review. Suppose, for example, that a dominant newspaper in a region agreed to pay another publisher not to enter the market. Would the Second Circuit analysis still require a district court to balance the harm to advertisers (who would lose a potential competitive source) against the benefit to readers (who arguably

might get lower subscription prices or better news coverage from a more profitable newspaper)?[3]

C. Need for a Practical Litigation Mandate

The Second Circuit's resolution of the two-sided platform issue is also impractical from a litigation and counseling standpoint. Trial courts are ill-equipped, and even ill-advised, to weigh competitive burdens to one group (merchants) against purported rewards to another (consumers). Consider Amex's conduct in the context of the airline industry: a district court would be expected to weigh anticompetitive costs to the airlines against whatever part of the issuer's supracompetitive profits might be shared with consumers in a separate market, as well as the consumer harm passed through by the airlines. How would a court calculate the marketplace benefits of consumer entitlement to rewards (which might or might not be exercised) against the costs to the airlines coupled with the consumer cost of merchant fees passed on?

Just as importantly, how would any enterprise or its antitrust counsel be able to predict the outcome? Counselors could not practicably predict whether economic benefits to one group would be as important to the marketplace as the harm imposed on another group.

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[3] That this should be a political choice, not a judicial one, is illustrated by the Newspaper Preservation Act of 1970, 15 U.S.C. §§ 1801, et seq., where Congress did exactly this. This statute permitted, under an exemption that had to be authorized by the Attorney General, two newspapers in a community to agree on advertising if this action was necessary for both papers to survive. *See* 15 U.S.C. §§ 1802(2), 1803.

The Second Circuit's approach to two-sided platforms necessarily embroils a trial court in the very administrative quagmire that this Court tried to avoid with its decision in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), where it held that indirect purchasers could not sue for antitrust damages under federal law. The Second Circuit would require the trial court to evaluate the effect on the cardholder side of the market in order to draw any conclusion about the restraint imposed upon merchants on the network services side. But as the District Court found in the current case, the net effect on cardholders includes the amount of overcharges passed through to consumers by merchants. As this Court observed in *Illinois Brick*, tracing pass-through costs from upstream misconduct is unworkable: "the attempt to trace the complex economic adjustments to a change in the cost of a particular factor of production would greatly complicate and reduce the effectiveness of already protracted treble-damages proceedings . . . ." 431 U.S. at 732. How would a court ascertain the amount by which a sandwich shop increased the price of a BLT as the result of the unlawful portion of a merchant fee? The Second Circuit failed to address this inconsistency with established precedent, and imposes an unworkable standard.

The lack of a practical and predictable framework for two-sided platforms under the Second Circuit approach would leave district courts an exceptionally difficult challenge of how to run a trial under the modern rule of reason. The vast amount of economic activity on relatively new and emerging two-sided platforms, and the expanded reach of the rule of reason under recent case law, make it imperative that this Court clarify the law and impose a more efficient

and workable order consistent with antitrust law policy.

CONCLUSION

Taking all these factors together this Court ought to make clear that, in judging monopolistic conduct or anticompetitive restraints that occur on one side of a two-sided platform, a district court should normally (1) treat that market as being distinct from the market on the other side, and (2) apply normal antitrust rules to the anticompetitive or monopolistic conduct in that market, as the District Court did in this case.

Respectfully submitted,

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